RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

July 15, 1987 **LETTER 969**

July 2 DJIA 2436.70; PTI 2636; A-D Ratio -5.48
July 10 DJIA 2455.99; PTI 2653; A-D Ratio -5.08

THE MARKET: Everyone wants structure, stone monuments, certainties. For instance, Reagan is a great president; the US is the world leader; I have a million dollars -- I'm rich; IBM is the ultimate growth stock, and this is unquestionably a bull market.

Unfortunately, the world doesn't work that way. It doesn't work that way because structures and monuments are inherently dead. And certainties have to do with structures and monuments.

But life has to do with change and PROCESS. For instance, Reagan seemed like a great president for a while, but now there are increasing doubts about his place in history. The US has been the world leader since WW II, but now our power is dwindling. If you have a million dollars you may consider yourself rich, but there are so many millionaires around today that the definition of "rich" may have to change. IBM was considered by many to be the ultimate growth stock, but don't put all your money on IBM -- the competition is getting vicious.

How about the stock market? This market was last reconfirmed as a primary bull market (via Dow Theory) on June 16. But the *market is a process too* -- the market is a living thing, and like all living things it is evolving constantly.

The great psychiatrist, Frederick Perls, when asked for a definition of a mature person, stated that there is no such thing as a mature person. There is no maturity," he said, "there is only the process of maturing."

It is the same with the stock market. Everyone is searching for certainty in the market. Everyone wants to know if this is unquestionably a bull market and, moreover, they want to know exactly how high the bull market is going to climb, and on what day of the month the bull market will end.

Veteran market practitioners may mull over those questions, but they are too intelligent and too seasoned to ask them out loud. They don't ask the questions because they have *learned to live with process* and they have learned that the stock market, like all life, is always in the process of evolution. Seasoned investors know that a bull market is born, it grows, it reaches (just as you and I do) a period of peak strength, and then the bull market begins the process of dying.

And at some point in the bull market process the seeds of the next primary bear market begin to germinate and grow. As the bear market grows, the bull market weakens (although to you and me and the newspapers and analysts, it's still a bull market). And then at some point the bear becomes actually STRONGER than the dying bull. Finally the bull dies and the bear comes out of its lair and starts moving toward its full strength, even as the tiny seeds of the next bull market are germinating.

What I've described above is process, not structure. That process applies to you and me, it pertains to the markets, it applies to every stock on every exchange, it applies to all nations, and it applies to the planets and the solar system.

Nevertheless, we have to operate in the market, and for that reason we turn the process into a structure and we term that process "a bull market" at one stage and "a bear market" at another stage. And finally we come down to the obvious question, which is, "At what stage in the great evolving process is the stock market NOW?"

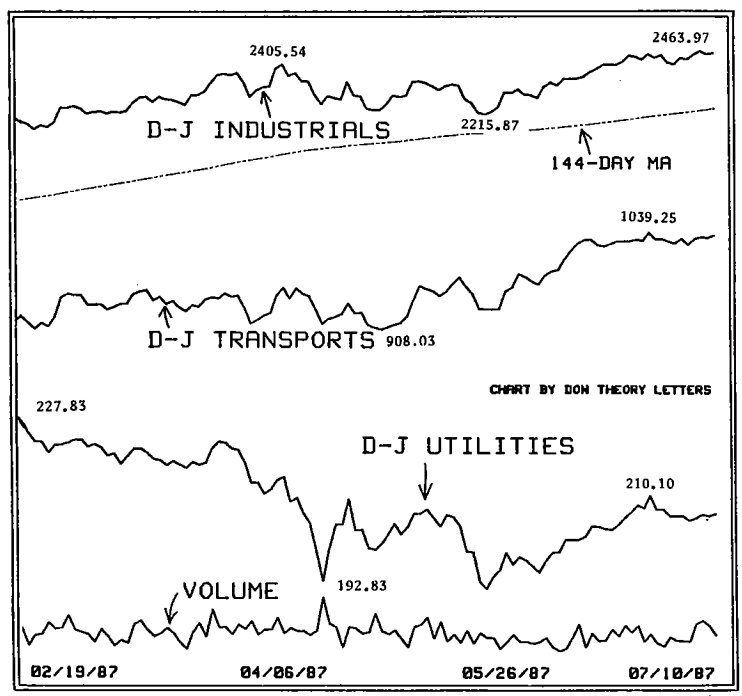
I classify this market today as a reconfirmed bull market. I do this based on the fact that the D-J Industrial Average on June 16 rose to a new bull market high, thereby confirming the prior bullish indications of the Transportation Average. Since June 16 most of the other major averages and indices have risen to new bull market highs, and that, of course, is a plus for this market. *But I also keep in mind that each reconfirmation in a bull market has less validity than the preceding one, and that ultimately there must be a "false reconfirmation" that will be the final reconfirmation prior to the next bear market.*

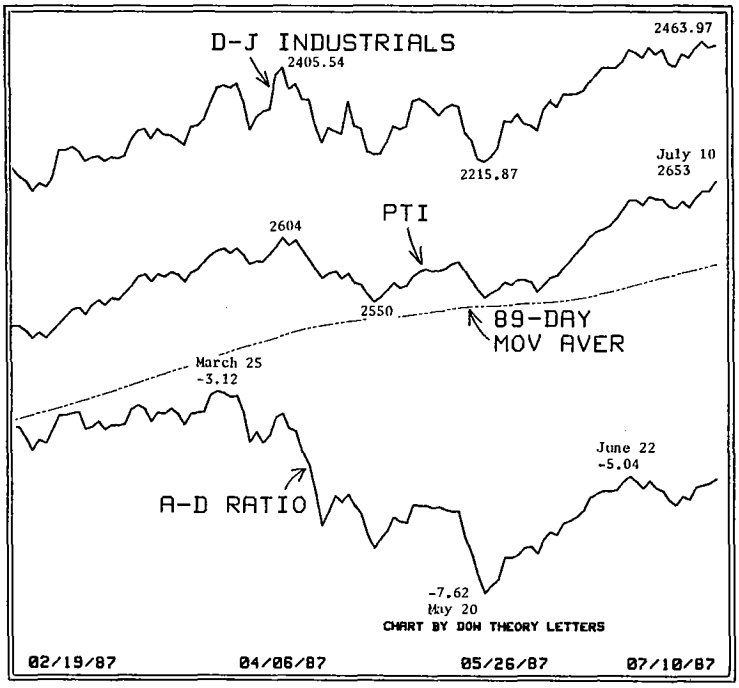
So even though I classify the market today as a bull market I am watching certain indications that suggest that the bull could be in the slow process of dying. Here are a few of the items I am watching:

(1) The D-J Utility Average recorded its bull market high back on January 22 at 227.83. The Utility Average has, in the past, topped out before, coincident with, or even after the rest of the market. But from past experience I have learned never to write off a stubborn and resistant peak in the Utility Average. Sure, the Utilities may yet rally above 227.83, but don't count on it. Until they do better their previous high, the January 22 peak will serve as an early warning sign.

(2) The advance-decline ratio (which tracks the advancing or declining trend of the majority of stocks on the NYSE) hit its bull market high on March 25. It will soon be four months since the A-D peaked, and based on past case history that's not a good omen (see page 2 chart). Persistent resistance to new highs on the part of the A-D ratio is often an indication that a market top is in progress.

(3) The A-D line for the 30 Dow Industrial stocks recorded its high on April 6. The Dow has continued on to new highs while the





Dow's own A-D line has lagged. Such price/breadth divergence is a negative for the Dow and for the market.

(4) My five-day average of daily new highs topped out at 187 on January 15. In the six months since, we have failed to come near that total, even though the Dow is now 360 points higher than it was at its January 15 level.

The above are all longer term non-confirmation problems, but none of them should be ignored. Nearer term we have the bull market highs to watch and they are 2463.97 for Industrials and 1039.25 for the Transports. A bettering of both of those highs would represent yet another bullish upside re-confirmation for the stock market.

Comment: Investment Quality Trends here in La Jolla does a fine job of gauging stock and market values. They do it by closely monitoring a universe of 350 selected blue-chip issues. In their latest issue IQT notes that 36% of their blue-chips are now in the "overvalued" zone. This is the highest overvalued count in 25 years except for the 37% overvalued of March 1987.

INVESTMENT POSITION: After 40 years of watching the stock market, I must say that I am surprised that the market still fascinates me. But it does. For instance, look at the situation today. Here we are with a classic four-month price/breadth divergence all within a recently reconfirmed bull market. Will the bull win out and will the market push substantially higher? Or is the four-month price/breadth divergence telling us that the great bull is living on borrowed time?

I'll admit that I don't have the definitive answer to that one, nor do any other "geniuses" who are quoted daily (actually hourly) on Wall Street. The fact is that most of the better stocks are currently overvalued and the bull market remains uncorrected -- so my advice "to take some profits" still stands.

The bull remains in the box. Why? Because despite the technical problems "it's still a confirmed bull market." The bull pictured in the box is a one-horned bull -- I removed one of his horns because the Dow (at its current minuscule yield of 2.8%) is as overvalued as it has been any time in its 90-year history.

WHERE THE STRENGTH IS: If you've been a subscriber to these reports for two or three years or longer, you will note that I harped on one theme in my stock recommendations. I said, "My work shows that the blue-chip stocks are going to be the STRONG segment of this market, and that means the D-J Industrial-type stocks. So why not buy the strongest of the Dow stocks? These will be the ultimate winners."

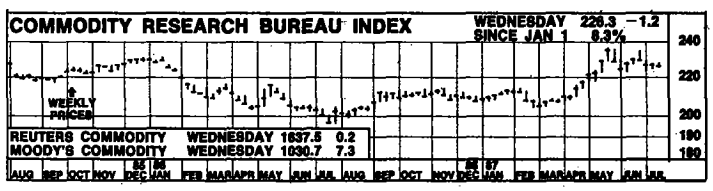
In retrospect that advice has proven to be correct. Dow stocks that I recommended over and over were duPont, Exxon, GE, Merck, Philip Morris, Proctor & Gamble, Westinghouse and Woolworth. All of these were recommended on the basis of the Dow's relative strength (RS) being superior to that of the other major averages and these particular stocks being the best of the Dow in terms of relative strength.

How has this policy fared? Here are some results: over the last 12 months duPont is up 44%, Exxon is up 32%, GE is up 29%, Merck is up 39%, Philip Morris is up 24%, Proctor is up 27%, Westinghouse is up 16% and Woolworth is up 41%.

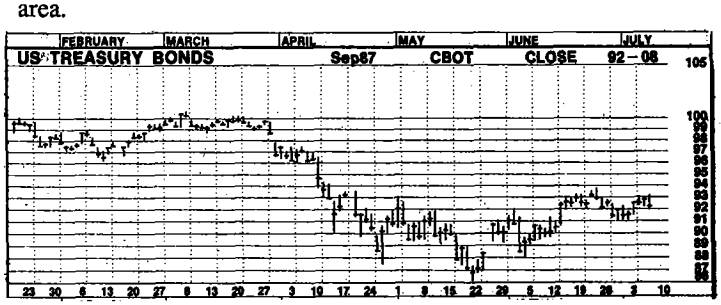
Surprisingly, over a five-year period only two Dow stocks are up over 300% -- Woolworth up 322% and Merck up 306%. Only four Dow stocks have better than doubled over the past five years -- duPont, Westinghouse, Exxon, McDonalds.

CHARTS: Inflation or not? The CRB Futures Index (27 different commodities) has been one of the places analysts look when they want to see whether inflation is heating up or not. Lately, the criticism has been that this index is too heavily weighted for the grains, but even so, it is an index worth watching.

The CRB Index popped during the March-May period, rallying from the low 200s to 236. But during May and June (as grain prices sank), the Index calmed down, and most recently it has been holding steady in the 226-28 area. Prognosis: Firming prices on many commodities, but not big inflation yet.

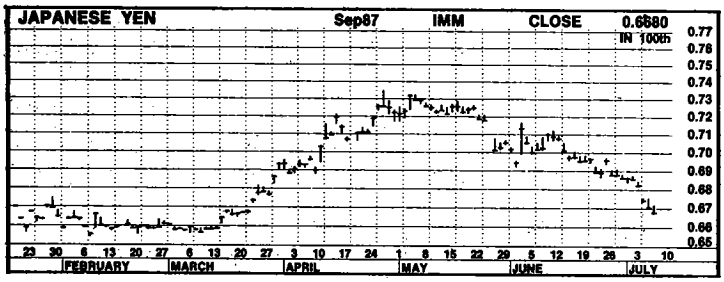


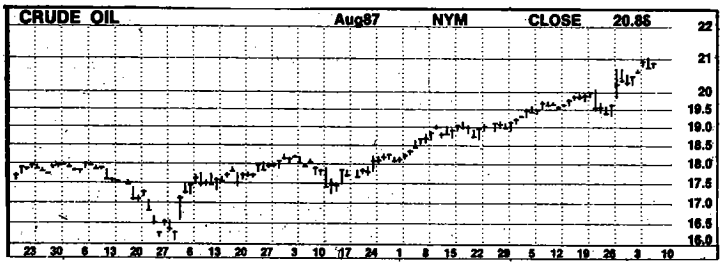
Bonds: The question of the hour, "What are the bonds going to do?" I have felt that the bonds were tracing out a large head-and-shoulders base, and as of now I would have to think that this is still the case. The right shoulder is stretching out a bit far at present, but patterns are never picture perfect. If the bonds are going to be winners, the September T-bond contract shown here should rally above 94. On the other hand, if the pattern fails there should still be massive support for the September bonds in the 93 area.



The Yankee dollar has strengthened considerably against most currencies, particularly the Japanese yen (shown here). The big April-July drop in the yen may be getting a bit overdone at present, and I therefore expect a general currency advance against the dollar. Note the big support on the September yen in the .66 area.

The big surprise (but, not I trust, to my subscribers) was the steady rise in oil. At just below $21 a barrel, crude has regained roughly half of its earlier panic losses. If oil can climb above 21 into the 22-23 area, it will be most impressive and certainly suggest that



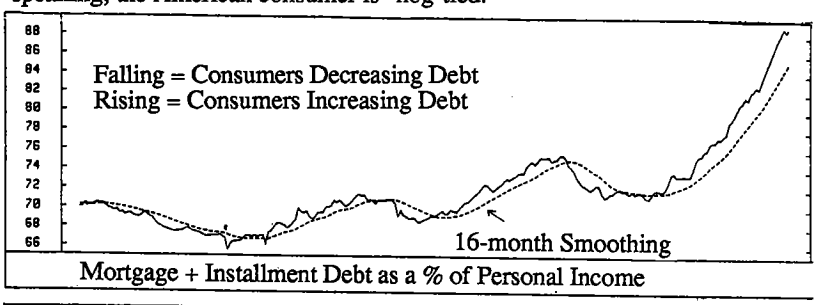


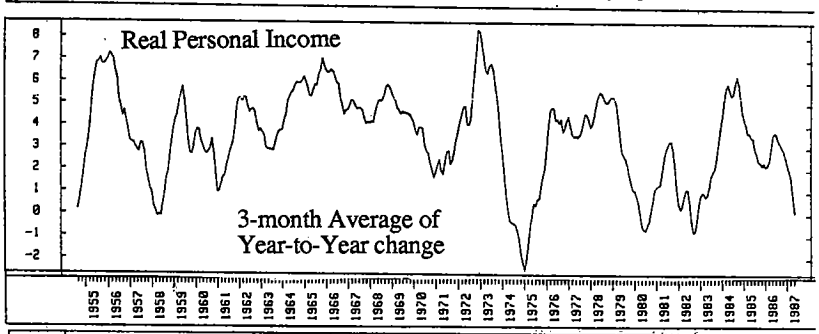
something more is happening -- something more than the automatic 50% retracement that occurs after almost all panic declines.

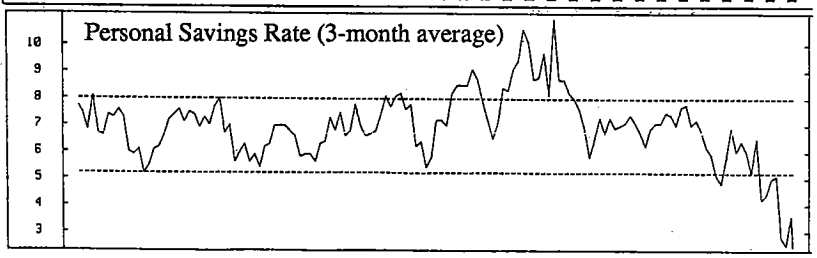
ECONOMICS: I must confess that I am rather fascinated with the picture shown on the accompanying charts (the first three charts are courtesy of my friends Davis and Zweig -- Business Timing Guide, PO Box 5345, NYC 10150). What the charts tell us is that the American consumer is pretty well bought up. He's up to his neck in debt (top chart), and that debt (mortgage payments plus installment debt) is taking up darn near 90% of all his after-tax income.

Not only is the debt tending to leave the American consumer strapped for cash, but his real (inflation adjusted) income is declining on a year-to-year basis (you can see this on the middle chart).

Finally, the American consumers' savings rate (bottom chart) has now dropped to 2.45%, the lowest figure on record. Financially speaking, the American consumer is "hog-tied."


Falling = Consumers Decreasing Debt
Rising = Consumers Increasing Debt
16-month Smoothing
Mortgage + Installment Debt as a % of Personal Income





"OK, interesting figures, but what's wrong with the consumer being hog-tied?" you ask. The problem with the consumer being debt-logged is that consumer buying accounts for roughly two-thirds of all business activity. Therefore, the condition pictured on these two charts is almost sure to create problems for the US economy in the period ahead.

Somewhere along the line, the consumer is going to cut back and start paying off his debts and building up his savings again. When that happens, the economy is going to slide -- unless something else comes along to take up the slack. The only thing I can think of that could take the place of contracting consumer spending would be a pick-up in US exports. Perhaps the lower dollar will put American manufacturers in a strong enough position to boost exports. This could occur, and in truth, the trend (although not impressive) is towards rising US exports.

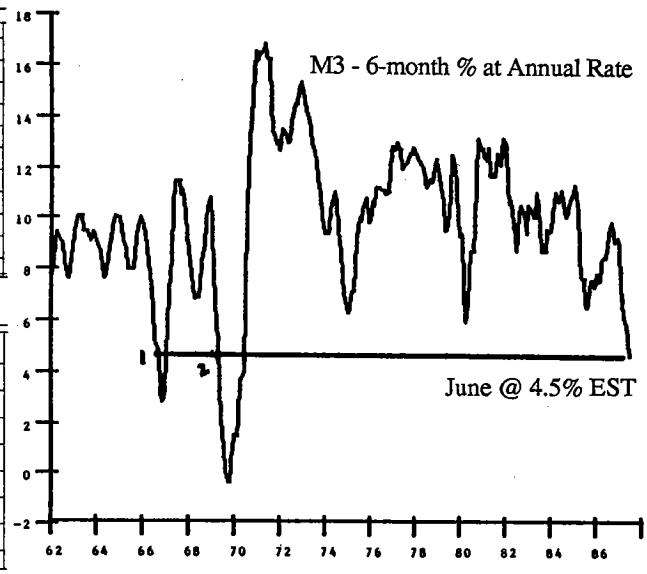
The American consumer's buying explosion has not been without its international aspects. Due to bulging imports and sagging exports, the US external debt rose to a frightening $236 billion last year. Says Toyo Gyohten, Japanese vice-minister of finance, "many countries took advantage of the surge in US demand and boosted their exports to the American market. ... Their exports were restructured dangerously and these nations became dependent on the US economy."

The $236 billion external debt is proving expensive, and installments on that debt are running $67 billion a year. This is $67 billion out of the US economy, and if the trend continues it will result in a lowered US standard of living (remember, that $67 billion is not money spent or saved in the US, it's money being taken OUT of the US economy).

So the picture is as follows: a concerted cut-back by US consumers would have a very adverse impact on the exporting nations. The fact is that all through the 1980s the US has been a giant seller's bazaar for the world's exporting nations. But America's debts are piling ever higher, and the bazaar is growing tired.

The fourth chart is courtesy of C.J. Lawrence. This chart shows the rate of growth in M-3, the broad measure of the US money supply. The shocker here is that the rate of growth (annual rate) has now dropped to almost zero, the lowest level since the early 1970s. Obviously, the Fed is still worried about recession and has been holding back on the money supply. At the same time, the Fed is worried about the dollar and therefore does not want interest rates to drop too far.

So here we have a most interesting situation. The consumer is bought up, loaned up, and his cash flow has dropped off to a trickle. At the same time the Fed has



been tightening. Normally, this would be the formula for a recession, and it could be the reason why the advance-decline ratio (a proxy for the average stock) has been acting so poorly. On the other hand, the business statistics are looking fairly good, the leading indicators are still rising, unemployment is way down, the purchasing agents are happy, and the American consumer is feeling good.

Conclusion: This is about as interesting and puzzling a picture as I've ever seen both in regards to Wall Street and the economy. As always, I'm going to let the stock market do the talking and predicting. Patience is needed here. The market will tell us its story in its own good time.

AMERICA'S CHOICES: Last week an excellent article appeared on the op/ed page of the New York Times (perhaps significantly, it appeared on July 4). The article was written by Richard Fisher, managing partner of Fisher Capital Management of Dallas. I was surprised that the article appeared in the normally super-liberal NY Times, but there it was.

In the Notes & Quotes section of this Letter I have presented a picture of the watershed changes which now confront Russia. I firmly believe that the following article lays out the *two possible choices confronting the US.* We will take one of these paths -- either willingly or unwillingly. In brief, I thought this article was so extremely important that I wanted to present it here for my subscribers to study. The path we embark on will ultimately affect ALL investments.

I was born in the 1940's at the dawn of America's global prosperity. With the Great Depression and Great War behind us, the United States emerged as the pre-eminent global power. Indeed, over the next 40 years our economy propelled the world forward. At home, America set the pace for the world in inventiveness, in creating jobs, in raising living standards. Abroad, we shaped the trading and monetary systems as masters of a smooth-running, free-trading economy, as custodians of a well-managed currency and as financiers of the world.

Our economic might underwrote peace and prosperity. It provided the military wherewithal to repel Soviet encroachment on democracy. It provided for the resurrection of the great nations in Europe and the Pacific. It became the global catalyst of reform, of growth, of hope for the future.

This is the happy world my generation grew up with. And this, regrettably, is the world that is no more.

We have lost our way. Our claim to inventiveness and capitalist accomplishment has been surrendered to the Japanese and others who once cowered in the presence of our economic might. We were once the progenitors of a world order of free trade and stable monetary order. We are now its biggest threat.

Democrats, the political children of the free-trader Franklin D. Roosevelt, campaign for the Presidency on platforms of protectionism and economic nationalism. Their Republican counterparts preside over policies that have debased our currency, destabilized global trade in money and goods and set the stage for an inevitable demise in our economy and our prestige. They cannot balance our budget. They cannot even finance domestically our own Government. They have led us into becoming the largest debtors in the history of mankind.

For a moment, it looked as if Ronald Reagan would succeed. His persona revived our spirit. His enthusiasm fueled our belief in the magic of growth and the majesty of our military might. But he took a big gamble. He financed America's renaissance with huge amounts of debt. Embracing untested supply-side theories, he borrowed from the future by leveraging the economy to the hilt. Growth today, he said, would be financed tomorrow. The gamble failed.

A great nation simply cannot control its destiny without control of its financial wherewithal. It cannot, for example, lean on the Japanese when it is dependent, as we are, on Japanese capital to finance its economic growth, and, indeed, its social-welfare system and its military. It cannot insure stability in Mexico and Latin America without providing the capital and markets necessary to keep these nations from resorting to non-democratic alternatives. It cannot fulfill the dream of responsibly removing nuclear weapons from its front-line defense in Europe when it cannot pay the greater cost of bolstering conventional weaponry and manpower.

Thus our destiny as a nation has come to a fork in a one-way road. Unable to go back, we can go forward in either of two directions.

One route contemplates an attempt to retain our prominence as leader of the free world. It is the immediately more painful alternative, for it requires that we get our economic house in order.

It requires that we eliminate our lenders in the only way it can be done: by cutting spending and raising taxes. It means tightening our belts severely. It implies slowing growth and a temporary recession.

To be sure, a self-inflicted recession would be tough on Texans, on farmers in Kansas, on workers in all industries. And it would be brutal for Mexico and other third world countries that depend on United States growth to sustain themselves.

But if we work closely with our allies, we could weather the storm. In return for our taking this bitter medicine, they must be willing to take up the slack by opening their purses and their markets. For they, too, realize that if we do not get on with it now, postponing the cure until later will be more painful and possibly fatal.

Politically, it is doubtful that we will take this road. The President, blind to the frightful risk he has imposed upon the nation, still believes you can sustain a trillion dollar defense and economic growth by borrowing from others. And no candidate to replace him, Republican or Democrat, has the backbone to call for the harsh measures we must take — including higher taxes and reduced social spending — if we want future generations to enjoy America's glory. They remember how easy it was for Ronald Reagan to defeat Walter F. Mondale with utopian economics.

This leaves us with the second course. It is to admit to ourselves and to the world that we are no longer fit to take the lead. We have allowed ourselves to be overcome by the syphilis of debt and cannot bear to take the medicine. Thus, we should notify our allies that we wish to relinquish our role as the fulcrum of global growth and protector of world freedom and retreat into the status of an equal but not pre-eminent power.

In some areas, such as the defense of the North Atlantic, we would arrange to share our obligations on an equal basis with West Germany, France and Britain — and not as supreme commander. In other areas, such as the International Monetary Fund and the economic arenas, we would hand the baton to Japan. In almost all world forums we would move out of the driver's seat and take a seat elsewhere on the bus.

It is impossible to estimate the degree to which acquiescence of this kind would demoralize the people of the Western world and encourage the Soviet Union. Still, telling the truth is better than living a lie. If we haven't the will to stay on top, we must arrange for others to fill the void.

President Reagan and his potential successors appear to have chosen the second option. Maybe this is what the American people want. We can certainly live with it. Many of our global obligations are tiresome burdens. It might be nice to simply acquiesce. But having grown up spoiled, I confess the prospect depresses me. I was always proud to be an American — to be the best, the strongest, the richest. I would like my children to experience the same feelings.

NOTES & QUOTES: The Big Red Shock lies ahead. Gorbachev's plans for "making Russia work" are moving into place. Between now and the end of the century, Russia plans to lay off 20 million people from its industrial and agricultural work forces. These people will be expected to find (that's right, find) jobs in service industries. Even more politically explosive -- beginning around 1990 Russia will see the end of state food subsidies, and a lifting of price controls on retail goods, all of which will bring a sharp rise in the Russian cost of living. More shocks: factories are to be free to fire unneeded or inefficient workers, and these factories will not be required to find the workers other jobs. Finally, mom and pop businesses will be allowed. The biggest problem, states Leonard Abalkin, a Soviet economist who was interviewed last week, will be fear on the part of Soviet citizens who are used to having everything decided for them -- everything from where they will live to what job they will hold to how much they will earn.

Russell comment: This is the wave of the future for Russia, and the reason is simple: The *Russian system of central planning doesn't work*, and Gorbachev knows it and has said it — out loud! The new reforms will thrust Russia straight into the global economic system. World economic trends, profits, pricing, all these will influence the "new Russia." Communism will no longer think of itself as immune from capitalist economic problems. Russia will also be forced to cut back on military expenditures (if that is not happening already) in order to boost domestic production.

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Japan Facts: Japan's land mass is slightly greater than the state of California. Yet the real estate value of Japan is greater than the real estate value of all the US's real estate. The Japanese stock market has been rising for nine years without a major correction. Since 1965 the Japanese stock market has outdistanced the Dow in percentage appreciation by 20 times. The value of all stocks on the Tokyo exchange this year surpassed the total value of all stocks on the AMEX and the NYSE. Is something wrong? Maybe, but go argue with the figures.

* *

US Retailing: The luxury watch industry appears to be "flipping out." Rolex started the trend toward super-priced watches with their widely-advertised 18-kt gold watches selling for thousands of dollars. The 18K Rolex "President" man's watch now sells for just under $10,000. Patek Philippe also sells its own 18K version at around the same price. But the imitators are rushing in with their own 18K gold entrants. Last week Jean Lassale of Geneva advertised watches at prices of up to $45,000. And Gerald Genta advertised (in the NY Times) its 18K gold "Spirit" watch for a mere $33,000. Things are getting rather silly in watch-land.

* *

Speaking of expensive baubles, a few weeks ago Sotheby's auctioned off a 36-carat flawless diamond for a record price of $2.2 million or a whopping $60,000 a carat. The June 29 Rapaport Diamond report notes that large diamonds are now much in demand, with many dealers holding back their wares for higher prices. ... Two weeks ago another Van Gogh painting ("Bridges") was sold, this time for $20 million. Note: Van Gogh sold only one painting in his entire lifetime. That painting was bought by his sympathetic brother, Theo.

* *

With the advance-decline ratio on the NYSE still below its March 25 peak and with the AMEX and NASDAQ lagging, the mutual funds are finding the going tougher. Lipper Analytical reports that of 1,247 funds of all types that it tracks, a total of 549 or 44% showed a negative return during the second quarter, even with dividends and interest reinvested.

* *

How are the banks faring? Ten of the big 12 money center banks have taken whopping write-offs on their LDC loans with only Wells Fargo and Morgan Guarantee abstaining. But the 1988 write-offs amount to only about 25% of their total exposure, so there will be more write-offs to come. The losses by the 10 biggies are equal to the profits of the 14,000 other US banks. (The above thanks to Lynch International Investment Survey, 301 Main St., Port Washington, NY 11050.)

* *

This is the 200th anniversary of the US Constitution. The famous Federalist papers, written by Alexander Hamilton and James Madison, dealt with the Constitution. In the Federalist papers we read: "If men were angels no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government that is to be administered by men over men, the great difficulty lies in this: You must first enable the government to control the governed; and in the next place oblige the government to control itself." And I guess that's what the Iran-Contra scandal is all about.

The writers of the Constitution were men who feared the power of government. Therefore, the thrust of the Constitution is a division of power among the three branches of government (so that each branch may check the power of the other). But in its special Constitution issue, Time magazine (July 6) asks whether the "fragmentation of powers" has "preserved liberty or brought government to a stalemate?" It's a good question. Time goes on, "The size of today's government has become a problem in itself. There are 20,000 people now serving Congress, virtually a separate government, which simply by political weight intrudes more and more into Executive matters. The White House, responding to that gauntlet, has 1,600 people on its roster. The thing they all do best these days is accuse one another and then argue."

* *

Statistics: Some of the universities enjoy big, and I mean HUGE, grants from the government for research and development. Here are the top beneficiaries: Johns Hopkins $429 million; MIT $187 mil.; Stanford $179 mil.; Univ. of Washington $146 mil.; UCLA $128 mil.; Columbia $127 mil.

* *

What are the largest associations in the nation? No. 1 is the American Automobile Assoc. with 26 million members. Second is the American Association of Retired Persons with 22 million members. Third is the YMCA and fourth is National Geographic. Fifth is Foundation for Support of International Medical Training with 6 million members. Does all this give any of my subscribers an idea for a new business? It should.

* *

The US birth rate per 1000 in 1970 was18.4 vs. 15.7 in 1985. Marriage per 1000 in 1970 was 10.6 vs. 10.2 in 1985. Divorce rate per 1000 in 1970 was 3.5 vs. 5.0 in 1980. Death rate per 1000 in 1970 was 9.5 vs. 8.7 in 1985.

* *

In trend-setting California's two giant public university systems, women have now taken a firm lead over men in both BAs and MAs. In the 1985-86 graduating classes, women took 42% of the law degrees, 41% of the medical degrees, 52% of the veterinary medicine degrees, 62% of the pharmacy degrees, and 51% of the biological science degrees.

* *

From our "Things to Come" Dept: I cut this delightful little clip from the June 29 LA Times. No, the piece was not written by a reporter, it was written by Carl Levin, Democratic senator from Michigan. Like I said, the Dems are just itching to raise taxes. So it looks like the ultimate deception is just an election away -- lower income taxes while taking away all the tax shelters, wait a year or so, and then raise income taxes again.

Is There Any Workable Way to Reduce the Federal Deficit?

Tax Rates for the Wealthiest Provide a Starting Place

By CARL LEVIN

Monday, June 29, 1987 / Part II

We all know the conventional wisdom in Washington. There is no significant support for modifying the income-tax rates of the 1986 Tax Reform Act to increase revenues to reduce the deficit. Supposedly, the ... nues to meet the goals of the fiscal 1988 budget resolution started to get specific and when it appeared that the Tax Reform Act of 1986 was being treated as sacrosanct, I sought to sample the views of the ... by raising excise taxes but by modifying last year's tax act by freezing the maximum income-tax rate for the topmost taxpayers. So the message is clear. The American public, by an overwhelming margin, does

DOW YIELD: Investment Quality Trends (La Jolla) notes that (total) dividends for the D-J Industrial Average for the 12 months ending in June 1987 rose a mere 1.7% -- from $68.19 to $69.36. Classically, the Dow has been considered "overvalued" any time it has risen to a point where its average yield has dropped to the

vicinity of 3%. With total dividends of $69.36 for the 30 Industrial stocks, the yield on the Dow is currently a minuscule 2.81%, one of the lowest Dow yields in stock market history.

GOLD, PRECIOUS METALS: A few Letters back I wrote about the coming (over the next five years) 25% boost in gold production. Coincidentally, in Barron's (May 22 issue) there appeared an article, the gist of which was that too much gold is currently being produced throughout the world. Of course, the author of the Barron's article failed to ask the basic question regarding the gold equation. The question is, "Too much gold compared with what?"

There are only two monetary reserves in the world -- one is gold and the other is paper currency. So the essential comparison must be the amount of gold being produced compared with the amount of paper currencies being produced. Currently, all the gold mines in the world produce roughly $30 billion of gold annually. But over the last 12 months the US money supply alone increased over $100 billion. Add to this all the money produced by the rest of the world and you have an equation that probably equals 20 parts or more of new paper being produced for every one part of gold. So in answer to the statement that "too much gold is being produced" I repeat, "Too much gold compared with what?"

Let's look at gold from another standpoint. The advantage of gold is that it is "forever." On the other hand, the sad history of every paper currency ever invented (or should I say printed) is that in time that currency has become worthless. The history of gold is that it has remained, and always will, a store of value.

The amount of interest a currency draws is based on, among others things, the risk involved in holding that currency. Since there is no obsolescence risk and no inflation risk in holding gold, gold doesn't have to pay any interest.

On the other hand, over the shorter term there is a penalty involved in holding gold, and that penalty is the loss of interest. For the long-term safety which one enjoys in holding gold, one must forego interest payments.

Consequently, investors will hold varying quantities of gold (1) when they fear inflation, or (2) when they fear for the safety of their currency. At any other time (in times of low or non-inflation and during times of high confidence), investors would rather reap the interest-return benefits of holding paper currency.

This is the reason why I have advocated holding gold only as an insurance vehicle. I haven't been particularly interested in speculating in gold or silver shares since I do not consider these as true substitutes for gold bullion. However, in view of the steady build-up in US deficits, I continue to advocate the systematic accumulation of gold bullion coins. My view is that gold coins are not a vehicle for speculation, but they should be an integral part of every diversified portfolio.

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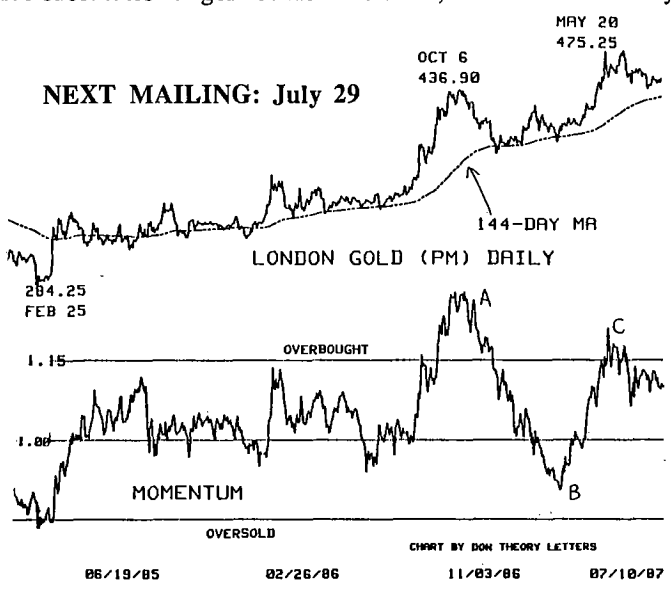

In the end, the amount of gold being mined will not determine the value of gold in terms of paper money. The trend of world inflation (or deflation), the trend of world debt, the trend of the world economy, these will be the trend-setters for gold. And since the US and the world economy are in a tenuous and debt-logged state, my feeling all along has been that gold accumulation in the form of gold coins is highly desirable. I still feel that way.

Furthermore, unlike my "load up on gold" position during the 1970s, I have not advised a big "load up on gold" position in the '80s. Rather I have advised (since 1985) a gradual position in gold coins based on a monthly fixed-dollar buying program. I continue to believe that a monthly gold-buying plan is warranted.

Turning to the gold chart, note that gold is still climbing bullishly ABOVE its 144-day moving average (which now stands at 430). The momentum index, however, suggests a less clear picture. Following the massive overbought area of late-1986 marked A on the chart, gold momentum sank to the semi-oversold area marked B. From there gold rose to a high price of 475.25 accompanied by a rise in the gold momentum index to the overbought area at C.

But since then the momentum index has never retreated to oversold again. This makes me wonder whether gold may not have to come down to test the 430 or even the 420 area (thereby producing something akin to oversold).

In a bull market a consolidation will often take the place of a correction, and this may be what we are seeing in gold now. At any rate, gold at this point seems to be in equilibrium with no strong impulse either up or down. Gold has been consolidating since May while holding above its MA, and on the face of it, that's a plus. Keep buying the coins.

LATE NOTES: This is one tough market, and I'm a guy who's seen a lot of tough ones. Look at it this way: Here's a market that's been squeezing higher for months in the face of a weakened Presidency, a churlish Congress, a new and untried Fed chairman, declining money supply, sluggish auto sales, a lagging market in secondary stocks, rising oil prices, and a shaky Middle-East situation. Is there something in the future, something highly bullish, that the market (in its eerie wisdom) is discounting? It would almost seem so.

The other side of the mystery coin is this: We also have a market that is suspiciously fragmented in that the Utility Average has topped out, the breadth indices, new highs, and the bond market are lagging, momentum has died down and the fundamentals (in terms of overvaluation) are spectacularly thin.

If we can ignore the lagging breadth picture, we should note that the two D-J Averages are within a few percentages of all-time highs (the highs being 2463.97 for the Industrials, 1039.25 for the Transports). On top of that, the market has been led up (as it has from 1984 through '87) by my Primary Trend Index, which at last glance stood at an all time high of 2653 (see page 2 chart). The PTI is also a fat 71 points above its 89-day moving average.

Perhaps the wisest words about the market can be summed up as follows (and I have repeated these words dozens and dozens of times): "Always stay on the right side of the PTI. The right side being on the bull side when the PTI is in a rising trend, and on the sidelines when the PTI is in a declining trend."

I've been computing the PTI on a daily basis for the past 16 years, and I've often wondered why this indicator has been so amazingly successful. My answer is this: No one but Richard Russell knows the composition of the PTI, and therefore no other advisories or institutions can pre-empt it. The corollary to that is that the PTI therefore has a limited following (limited to readers of Dow Theory Letters) which means that the PTI can never become "too popular" (in this business "too popular" is tantamount to being useless).